Synacor, Inc.
Form 10-Q
May 10, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-33843

Synacor, Inc.

(Exact name of registrant as specified in its charter)

Delaware	16-1542712
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

40 La Riviere Drive, Suite 300 14202

Buffalo, New York
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (716) 853-1362

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 4, 2018, there were 38,796,722 shares of the registrant's common stock outstanding.

SYNACOR, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SYNACOR, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED
AS OF MARCH 31, 2018 AND DECEMBER 31, 2017
(In thousands except for share and per share data)

	March 31, 2018	December 31, 2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$16,425	$ 22,476
Accounts receivable, net of allowance of $96 and $99, respectively	24,179	31,696
Prepaid expenses and other current assets	5,741	4,516
Total current assets	46,345	58,688
PROPERTY AND EQUIPMENT, net	20,621	20,505
GOODWILL	15,950	15,955
INTANGIBLE ASSETS, net	12,159	12,695
OTHER ASSETS	649	937
Total assets	$95,724	$ 108,780
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$18,726	$ 25,931
Accrued expenses and other current liabilities	4,650	7,075
Current portion of deferred revenue	8,361	11,605
Current portion of capital lease obligations	2,405	2,444
Total current liabilities	34,142	47,055
LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS	2,770	3,371
DEFERRED REVENUE	3,598	3,682
DEFERRED INCOME TAXES	225	264
OTHER LONG-TERM LIABILITIES	59	63
Total liabilities	40,794	54,435
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS' EQUITY:		
Preferred stock – par value $0.01 per share; authorized 10,000,000 shares; none issued	—	—
Common stock – par value $0.01 per share; authorized 100,000,000 shares; 39,638,942 shares issued and 38,796,722 shares outstanding at March 31, 2018 and 39,625,980 shares issued and 38,783,760 shares	393	396

outstanding at December 31, 2017		
Treasury stock – at cost, 842,220 shares at March 31, 2018 and 842,220 shares at December 31, 2017	(1,881)	(1,881)
Additional paid-in capital	143,079	142,486
Accumulated deficit	(86,568)	(86,627)
Accumulated other comprehensive loss	(93)	(29)
Total stockholders' equity	54,930	54,345
Total liabilities and stockholders' equity	$95,724	$ 108,780

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(In thousands except for share and per share data)

	Three Months Ended March 31, 2018	2017
REVENUE	$32,915	$26,540
COSTS AND OPERATING EXPENSES:		
Cost of revenue (exclusive of depreciation and amortization shown separately below)	15,217	12,562
Technology and development (exclusive of depreciation and amortization shown separately below)	6,687	7,298
Sales and marketing	5,936	6,661
General and administrative (exclusive of depreciation and amortization shown separately below)	5,017	3,964
Depreciation and amortization	2,435	2,184
Total costs and operating expenses	35,292	32,669
LOSS FROM OPERATIONS	(2,377)	(6,129)
OTHER INCOME	119	6
INTEREST EXPENSE	(97)	(87)
LOSS BEFORE INCOME TAXES	(2,355)	(6,210)
INCOME TAX PROVISION	20	446
NET LOSS	$(2,375)	$(6,656)
NET LOSS PER SHARE:		
Basic	$(0.06)	$(0.21)
Diluted	$(0.06)	$(0.21)
WEIGHTED AVERAGE SHARES USED TO COMPUTE NET LOSS PER SHARE:		
Basic	38,794,165	31,045,488
Diluted	38,794,165	31,045,488

The accompanying notes are an integral part of these condensed consolidated financial statements.

SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS – UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(In thousands)

	Three Months Ended March 31,	
	2018	2017
Net loss	$(2,375)	$(6,656)
Other comprehensive income:		
Changes in foreign currency translation adjustment	(64)	45
Comprehensive loss	$(2,439)	$(6,611)

The accompanying notes are an integral part of these condensed consolidated financial statements.

SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(In thousands)

	March 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(2,375)	$(6,656)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,435	2,184
Stock-based compensation expense	553	647
Provision for deferred income taxes	(39)	200
Increase in estimated value of contingent consideration	—	107
Changes in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable, net	7,517	10,151
Prepaid expenses and other assets	(942)	(342)
Accounts payable	(7,392)	(3,771)
Accrued expenses and other liabilities	(2,429)	(3,535)
Deferred revenue	(872)	48
Net cash used in operating activities	(3,544)	(967)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,924)	(1,515)
Net cash used in investing activities	(1,924)	(1,515)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on capital lease obligations	(520)	(319)
Proceeds from exercise of common stock options	18	308
Deferred acquisition payments	—	(567)
Net cash used in financing activities	(502)	(578)
Effect of exchange rate changes on cash and cash equivalents	(81)	6
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,051)	(3,054)
Cash and cash equivalents, beginning of period	22,476	14,315
Cash and cash equivalents, end of period	$16,425	$11,261
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$92	$69
Cash paid for income taxes	$106	$192
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Property, equipment and service center contracts financed under capital lease	$—	$521
Minimum capital lease payments in accounts payable	$160	$—
Accrued property and equipment expenditures	$596	$269
Stock-based compensation capitalized to property and equipment	$19	$37

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SYNACOR, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

AS OF MARCH 31, 2018 AND DECEMBER 31, 2017, AND

FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017

1. The Company and Summary of Significant Accounting Principles
Synacor, Inc., together with its consolidated subsidiaries (collectively, the “Company” or “Synacor”), is the trusted technology development, multiplatform services and revenue partner for video, internet and communications providers, device manufacturers, governments and enterprises. Synacor enables its customers to provide their consumers engaging, multiscreen experiences and advertising to their consumers that require scale, actionable data and sophisticated implementation.

Basis of Presentation —

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company’s management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company’s financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period.

The accompanying condensed consolidated balance sheet as of March 31, 2018 was derived from the audited financial statements as of that date, but does not include all the information and footnotes required by U.S. GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Accounting Estimates —

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

Concentrations of Risk —

As of March 31, 2018 and December 31, 2017, the Company had concentrations equal to or exceeding 10% of the Company’s accounts receivable as follows:

	Accounts Receivable		
	March 31, 2018	December 31, 2017	
Google advertising affiliate	*	16	%
Google search	*	7	%
Advertising customer	*	12	%

* - Less than 10%

For the three months ended March 31, 2018 and 2017, the Company had concentrations equal to or exceeding 10% of the Company's revenue as follows:

	Revenue Three Months Ended March 31,		
	2018	2017	
Google search	15%	11	%
Google advertising affiliate	16%	*	

* - Less than 10%

For the three months ended March 31, 2018 and 2017, the following customers received revenue-share payments equal to or exceeding 10% of the Company's cost of revenue:

	Cost of Revenue Three Months Ended March 31,	
	2018	2017
Customer A	*	19 %
Customer B	20%	*
* - Less than 10%		

Recent Accounting Pronouncements —

Not Yet Adopted

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842) which amends lease accounting by lessors and lessees. This new standard will require, among other things, that lessees recognize a right-to-use asset and related lease liability for all significant financing and operating leases, and specifies where in the statement of cash flows the related lease payments are to be presented. The standard is effective for years beginning after December 15, 2018, including interim periods within those years (beginning in calendar year 2019 for the Company), and early adoption is permitted. The Company is currently in the process of evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements, but currently expects that all of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon the adoption of ASU 2016-02, which will increase the total assets and total liabilities that it reports as compared to those reported prior to adoption. The Company will adopt the standard on the required effective date, which for the Company will be January 1, 2019.

Recently Adopted

On January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers ("Topic 606"), using the modified retrospective method. Results for reporting periods beginning on or after January 1, 2018 are presented under Topic 606; however, prior period amounts are not adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. The Company recorded a reduction to the opening balance of the accumulated deficit of $2.5 million as of January 1, 2018 due to the cumulative impact of the adoption of Topic 606. The impact to revenue recorded for the quarter ended March 31, 2018 was a decrease of $0.2 million with the adoption of Topic 606 as compared to Topic 605.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. This ASU reduces the diversity in reporting of eight specific cash flow issues due to accounting guidance that is unclear or does not exist. The eight issues relate to certain debt activities, business combination activities, insurance settlements and other various activities. The Company adopted this ASU as of January 1, 2018 and it did not have an impact on our consolidated financial statements.

2. Revenue from Contracts with Customers

The following is a description of principal activities from which the Company generates revenue. Revenue is recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that is expected to be received in exchange for those goods or services. The Company generates all of our revenue from contracts with customers.

Search & Digital Advertising

The Company uses internet advertising to generate revenue from the traffic on our Managed Portals and Advertising solutions, categorized as search advertising and digital advertising. For search advertising, the Company has a revenue-sharing relationship with Google, pursuant to which the Company includes a Google-branded search tool on our Managed Portals. When a consumer makes a search query using this tool, the Company delivers the query to Google and they return search results to consumers that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us. The net payment received from Google is recognized as revenue. Digital advertising includes video, image and text advertisements delivered on our Managed Portals. Advertising inventory is filled with advertisements sourced by our direct sales force and advertising network partners. Revenue is generated when an advertisement displays, otherwise known as an impression, or when consumers view or click an advertisement, otherwise known as an action. Digital advertising revenue is on a cost per impression or cost per action basis. Digital advertising also includes advertising fees received for the placement of syndicated digital advertisements with other digital advertising publishers, for which the Company acquires and pay for the space (inventory) on a cost per impression or cost per action basis. Revenue is recognized based on amounts received from advertising customers as the impressions are delivered or the actions occur, according to contractually-determined rates.

Recurring and fee-based

Recurring and fee-based revenue includes subscription fees and other fees that are received from customers for the use of our proprietary technology, including the use of, or access to, email, Cloud ID, security services, games and other premium services and paid content. Monthly subscriber levels typically form the basis for generating Recurring and fee-based revenue. This revenue is typically determined by multiplying a per-subscriber per-month fee by the number of subscribers using the particular services being offered or consumed, except in the case of software licenses and support, which are based on a fixed fee. Revenue earned as subscription fees and maintenance and support fees is recognized from customers as our obligation to deliver the service is satisfied, which is when the service is delivered. Revenue is also recognized from the licensing and distribution of our Email/Collaboration products and services, including licenses of intellectual property. Software license revenue is recognized up front upon delivery of the licensed product and the utility that enables the customer to access authorization keys, provided that a signed contract has been received. The Company typically sells term-based software licenses that expire, which are referred to as subscription licenses, but also sell perpetual licenses for our Email products. The software is delivered before related services are provided and is functional without professional services, updates, and technical support.

Many of the Company’s contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are typically estimated using the residual approach. Standalone selling prices of services are typically estimated based on observable transactions when these services are sold on a standalone basis. The Company usually expects payment within 30 to 90 days from the invoice date (fulfillment of performance obligations or per contract terms). None of our contracts as of March 31, 2018 contained a significant financing component. Differences between the amount of revenue recognized and the amount invoiced, collected from, or paid to our customers are recognized as deferred revenue.

Disaggregation of revenue

The following table provides information about disaggregated revenue for the three months ended March 31, 2018 by primary geographical market and timing of revenue recognition, and includes a reconciliation of the disaggregated revenue with reportable types (in thousands):

	Geographic Area		Timing of Revenue Recognition		
	United States	International	Products transferred	Products and services	Total

			at a point in time	transferred over time	
	(in thousands)		(in thousands)		
Revenue:					
Search and digital advertising	$18,667	$ 1,161	$19,828	$ —	$19,828
Recurring and fee-based	8,371	4,716	2,214	10,873	$13,087
Total revenue	$27,038	$ 5,877	$22,042	$ 10,873	$32,915

Remaining Performance Obligations

Deferred revenue is recorded when cash payments are received or due in advance of revenue recognition from software licenses, professional services, and maintenance agreements. The timing of revenue recognition may differ from the timing of billings to customers. The changes in deferred revenue, inclusive of both current and long-term, are as follows:

(in thousands)	
Beginning balance - January 1, 2018	$15,287
Record the cumulative effect of ASC 606 implementation	(2,456)
Recognition of deferred revenue	(2,301)
Deferral of revenue	1,429
Ending Balance - March 31, 2018	$11,959

The portion of deferred revenue that is related to professional services is $0.2 million, which will be recognized over the next twelve months and is based upon a number of factors, including customers' needs and schedules. Client advances are pre-payments from customers for services not yet provided. The majority of the deferred revenue balance above relates to the maintenance and support contracts for Email software licenses. These are recognized straight-line over the life of the contract, with the majority of the balance being recognized within the next twelve months.

Practical Expedients

The Company generally expenses sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which revenue is recognized at the amount to which the Company has the right to invoice for services performed.

3. Acquisitions

In August 2015, the Company and Zimbra, Inc. (now known as “TZ Holdings”) entered into an agreement under which the Company acquired certain assets relating to TZ Holdings’ email/collaboration products and services business, including certain of its wholly-owned foreign subsidiaries, for cash consideration of $17.3 million, 2.4 million shares of common stock and warrants to purchase 480,000 shares of common stock (collectively valued at $3.2 million). The Company held back an additional 600,000 shares of common stock and warrants to purchase an additional 120,000 shares of common stock (collectively valued at $0.8 million at the acquisition date) to secure TZ Holdings’ indemnification obligations including pending claims. The held back common shares and warrants were released to TZ holdings in March 2017. The warrants expire on September 14, 2018.

Additionally, TZ Holdings was eligible to receive cash consideration of up to $2.0 million (the “Earn-Out Consideration”) upon the satisfaction of certain business performance milestones following the closing of the transaction, subject to and contingent upon any reduction to satisfy indemnification claims including pending claims. The acquisition date fair value of this contingent consideration was estimated to be $1.6 million. The Company paid $0.9 million of the Earn-Out Consideration to TZ Holdings in November 2016, and the Company paid the remaining $0.7 million of the Earn-Out Consideration in May 2017.

In connection with the Company’s February 2016 acquisition of Technorati, the Company withheld $0.5 million of the purchase price to secure Technorati’s indemnification obligations under the Asset Purchase Agreement, and the Company owed approximately $0.1 million in post-closing working capital adjustments. These amounts were paid in March 2017.

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Customer and publisher relationships	$14,780	$ 14,780
Technology	2,330	2,330
Trademark	300	300
	17,410	17,410
Less accumulated amortization	(5,251)	(4,715)

Intangible assets, net	$12,159	$ 12,695

Amortization of intangible assets totaled $0.5 million and $0.5 million for the three months ended March 31, 2018 and 2017, respectively.

5. Property and Equipment – Net
Property and equipment, net consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Computer equipment	$28,908	$ 28,845
Computer software	25,225	23,690
Furniture and fixtures	1,497	1,497
Leasehold improvements	1,213	1,215
Work in process (primarily software development costs)	4,148	3,758
Other	161	159
	61,152	59,164
Less accumulated depreciation	(40,531)	(38,659)
Property and equipment, net	$20,621	$ 20,505

Depreciation expense totaled $1.9 million and $1.6 million for the three months ended March 31, 2018 and 2017, respectively.

6. Accrued Expenses and Other Current Liabilities
Accrued expenses and other current liabilities consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Accrued compensation	$2,354	$ 4,361
Accrued content fees and other costs of revenue	628	655
Accrued taxes	186	426
Other	1,482	1,633
Total	$4,650	$ 7,075

7. Information About Segment and Geographic Areas
Operating segments are components of the Company in which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following tables set forth revenue and long-lived tangible assets by geographic area (in thousands):

	Three Months Ended March 31, 2018	2017
Revenue:		
United States	$27,038	$21,668
International	5,877	4,872
Total revenue	$32,915	$26,540

	March 31, 2018	December 31, 2017
Long-lived tangible assets:		
United States	$19,950	$ 19,775
International	671	730
Total long-lived tangible assets	$20,621	$ 20,505

8. Commitments and Contingencies
Contract Commitments —

The Company is obligated to make minimum payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of March 31, 2018 are as follows (in thousands):

Year ending December 31,	
2018 (remaining nine months)	$1,575
2019	2,053
2020	753
Total	$4,381

Capital Lease Commitments —

Capital lease commitments for the remainder of 2018 and for the following three years as of March 31, 2018 are summarized as follows (in thousands):

Years Ending December 31,	Capital Lease Commitments
2018 (remaining nine months)	$ 1,987
2019	2,348
2020	1,152
Total minimum capital lease commitments	5,487
Less-amount representing interest	(312)
Total capital lease obligations	5,175
Less-current portion of capital lease obligations	(2,405)
Long-term portion of capital lease obligations	$ 2,770

Litigation —

From time to time, the Company is a party to legal actions. In consultation with counsel, as it relates to any current pending matters, the outcome of these matters is not expected to have a material impact on the consolidated financial statements of the Company.

The Company and two of its executive officers were recently named as defendants in a putative securities class action lawsuit filed April 4, 2018 in the United States District Court for the Southern District of New York. The complaint makes various allegations regarding statements related to the contractual arrangement between the Company and AT&T Inc. (“AT&T”), and the effect of that arrangement on the Company’s revenue. The complaint seeks unspecified damages, interest and other costs. The case is still in its initial stage and a lead plaintiff has not yet been appointed. The Company and its officers dispute these claims and will defend vigorously against any allegations of wrongdoing.

9. Stock-based Compensation

The Company has stock-based employee compensation plans for which compensation cost is recognized in its financial statements. The cost is measured at the grant date, based on the fair value of the award, determined using the Black-Scholes option pricing model, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award).

No income tax deduction is allowed for incentive stock options ("ISOs"). Accordingly, no deferred income tax asset is recorded for the potential tax deduction related to these options. Expense related to stock option grants of non-qualified stock options ("NSOs") results in a temporary difference, which gives rise to a deferred tax asset.

Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Technology and development	$134	$208
Sales and marketing	138	168
General and administrative	281	271
Total stock-based compensation expense	$553	$647

Stock Option Activity – A summary of the stock option activity for the three months ended March 31, 2018 is presented below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2018	8,478,213	$ 2.60		
Granted	613,100	2.00		
Exercised	(10,439)	1.62		
Forfeited or expired	(179,229)	2.20		
Outstanding at March 31, 2018	8,901,645	$ 2.57	6.88	$ 103
Vested and expected to vest at March 31, 2018	8,609,183	$ 2.57	6.81	$ 100
Vested and exercisable at March 31, 2018	5,691,837	$ 2.59	5.94	$ 62

Aggregate intrinsic value represents the difference between the Company's closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company's closing stock price as reported on the Nasdaq Global Market as of March 31, 2018 was $1.60 per share. The total intrinsic value of options exercised for the three months ended March 31, 2018 was minimal. The weighted average fair value of options issued during the three months ended March 31, 2018 amounted to $0.99 per option share.

As of March 31, 2018, the unrecognized compensation cost related to non-vested options granted, for which vesting is probable, and adjusted for estimated forfeitures, was approximately $3.8 million. This cost is expected to be recognized over a weighted-average remaining period of 2.6 years.

10. Net Loss Per Common Share Data

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company’s potential common shares consist of the incremental common shares issuable upon the exercise of stock options, warrants, and to a lesser extent, shares issuable upon the release of RSUs. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

Stock options, warrants and RSUs are not included in the calculation of diluted net loss per share for the three months ended March 31, 2018 and 2017 because the Company had a net loss for each of those periods. The inclusion of these equity awards would have had an antidilutive effect on the calculation of diluted loss per share. As such, the Company’s calculations of basic and diluted net loss per share are identical.

The following table presents the calculation of basic and diluted net loss per share for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31, 2018	2017
Basic net loss per share:		
Numerator:		
Net loss (in thousands)	$(2,375)	$(6,656)
Denominator:		
Weighted average common shares outstanding	38,794,165	31,045,488
Basic net loss per share	$(0.06)	$(0.21)
Diluted net loss per share:		
Numerator:		
Net loss (in thousands)	$(2,375)	$(6,656)
Denominator:		
Weighted average common shares outstanding - basic	38,794,165	31,045,488
Add - potentially dilutive securities (options, RSUs and warrants)	—	—
Weighted average common shares outstanding - diluted	38,794,165	31,045,488
Diluted net loss per share	$(0.06)	$(0.21)

The following securities were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented:

	Three Months Ended March 31, 2018	2017
Anti-dilutive equity awards:		
Stock options	8,901,645	9,547,477
Restricted Stock Units	51,267	309,889
Warrants	600,000	600,000

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as “may,” “expect,” “believe,” “anticipate,” “intend,” “could,” “estimate,” or “continue,” ar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled “Risk Factors” included elsewhere in this Form 10-Q and in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management’s discussion and analysis of financial condition and results of operations appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Our Business

We enable our customers to better engage with their consumers. Our customers include video, internet and communications providers, device manufacturers, governments and enterprises. We are their trusted technology development, multiplatform services and revenue partner. Our customers use our technology platforms and services to scale their businesses and extend their subscriber relationships. We deliver managed portals, advertising solutions, email and collaboration platforms, and cloud-based identity management.

We enable our customers to provide their consumers engaging, multiscreen experiences with products that require scale, actionable data and sophisticated implementation. Through our Managed Portals and Advertising solutions, we enable our customers to earn incremental revenue by monetizing media among their consumers. At the same time, because consumers have high expectations for their online experience as a result of advances in video, mobile and social, we provide, through our Recurring and fee-based revenue solutions, a suite of products and services that helps our customers successfully meet those high expectations by enabling them to deliver to their consumers access to the same digital content across all devices, including PCs, tablets, smartphones and connected TVs.

Overview

We generate search and digital advertising revenue from consumer traffic on our Managed Portals and Advertising solutions, which we collect from our search partner, Google Inc., or Google, our advertising network providers and directly from advertisers. We typically share a portion of this Managed Portals and Advertising revenue with our customers. Growth in this portion of our business is dependent on expansion of relationships with our existing customers and new customers adopting our Managed Portals and Advertising solutions and increased engagement by their consumers with these solutions.

We also generate revenue from our Recurring and fee-based revenue solutions for the use of our technology, email and messaging, premium services and paid content. We generate this revenue in the form of licensing fees including perpetual licenses, subscription licenses, maintenance and support fees and professional services. As we expand our Cloud ID, syndicated content, Email/Collaboration and other premium services offerings, we expect to generate increased Recurring and fee-based revenue from our customers.

During the three months ended March 31, 2018, Managed Portals and Advertising revenue was $19.8 million, an increase of 46% as compared to $13.5 million for the three months ended March 31, 2017.

Search revenue increased by $2.2 million, or 78%, for the three months ended March 31, 2018 compared to the same period in 2017, due to search revenue attributable to the AT&T Portal (including personal computers, smartphones and tablets), which was fully deployed by the end of the second quarter of 2017, offset partially by the effects of ongoing migration of search activity at other portal customers from personal computers to other devices, such as tablets and smartphones, generally across the consumer base, and the residual effect of the placement of our Managed Portals and Advertising solutions on the second tab of the default Windows 8 and Windows 10 internet browsers.

Digital advertising revenue increased by $4.1 million, or 38%, during the three months ended March 31, 2018 as compared to the same period in 2017. The first quarter increase in digital advertising revenue was driven by advertising on the AT&T Portal and higher syndicated advertising revenue, partially offset by effects of ongoing migration of other portal customers from personal computers to other devices, such as tablets and smartphones, generally across the consumer base.

We expect that both search and digital advertising activity and revenue will increase in future quarters due to our three-year portal services contract with AT&T Services, Inc., or AT&T, to provide Managed Portals and Advertising solutions (including the AT&T Portal) for use by AT&T's consumers. We entered into the portal services contract with AT&T in May 2016, we completed deployment of the AT&T Portal in June 2017, and we expect to see increasing search and digital advertising revenue as monetization of the AT&T Portal is optimized. In addition, we expect a future increase of search activity on smartphones and tablets as we believe our continuing investment in our next-generation Managed Portals and Advertising solutions will allow us to compete more effectively for search activity on smartphones and tablets.

Our Recurring and fee-based revenue consists of fees charged for the use of our proprietary technology and for the use of, or access to, services, such as e-mail and messaging, security, Cloud ID, online games, music and other premium services and paid content. For the three months ended March 31, 2018, Recurring and fee-based revenue was $13.1 million, an increase of $0.1 million compared to the same period in 2017. This increase was primarily attributable to increased Cloud ID licensing revenue and increased professional services revenue, offset by decreased premium services and the effects of the transition of e-mail customers from perpetual to subscription license revenue.

As we obtain new customers and those new customers introduce our Managed Portals and Advertising solutions to their consumers, and as new customers migrate their consumers from their existing technology to our technology over a period of time, we expect usage of our solutions and revenue from those Managed Portals and Advertising solutions to increase. Moreover, a new customer may initially launch a selection of our services and products, rather than our entire suite of offerings and subsequently broaden their service and product offerings over time. When a customer launches a new service or product, marketing and promotional activities may be required to generate awareness and interest among consumers.

Revenue attributable to our customers includes the Recurring and fee-based revenue earned directly from them, as well as the Managed Portals and Advertising revenue generated through our relationships with our search and digital advertising partners (such as Google for search advertising and advertising networks, advertising agencies and advertisers for digital advertising). This revenue is attributable to our customers because it is produced from the traffic on our Managed Portals. These search and advertising partners provide us with advertisements that we then deliver with search results and other content on our Managed Portals. Since our search advertising partner, Google, and our advertising network partners generate their revenue by selling those advertisements, we create a revenue stream for these partners. In the three months ended March 31, 2018, search advertising through our relationship with Google generated $5.0 million or approximately 15% of our revenue (all of which was attributable to our customers). For the three months ended March 31, 2018, Managed Portals and Advertising solutions and other services attributable to one customer accounted for 26% of our revenue.

The initiatives described below under "Key Initiatives" are expected to contribute to our ability to maintain and grow revenue and return to operating profitability via increases in advertising revenue, increases in customers and our consumer reach, and increases in availability of products across more devices. We expect the period in which we experience a return on future investments in each of these initiatives to differ. For example, more direct advertising at higher rates would be expected to have an immediate and direct impact on profitability while expansion into international markets may require an investment that involves a longer term return.

Key Initiatives

Our strategy is supported by four key pillars to drive our business, with operational discipline and sound financial footing as its base. We plan to:

- increase value for existing customers by optimizing consumer experience and monetization;
- innovate on Synacor-as-a-platform for advanced services;
- win new customers in current and related verticals; and
- extend our product portfolio into emerging growth areas.

Key Business Metric

In addition to the line items in our financial statements, we review the number of Multiplatform Unique Visitors to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. Following the acquisition of the

Technorati media solutions platform in February 2016, our Multiplatform Unique Visitors metric includes the number of multiplatform unique visitors through our advertising network. We believe disclosing this metric is useful for investors and analysts to understand the underlying trends in our business. The following table reflects the number of multiplatform unique visitors for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,	
	2018	2017
Multiplatform Unique Visitors	202,240,124	200,818,239

We define Multiplatform Unique Visitors as consumers who have visited one of our Managed Portals from either mobile or desktop sources at least once, computed on an average monthly basis during a particular time period, plus the number of consumers who have viewed an advertisement through our advertising network, computed on an average monthly basis during a particular time period. As the number of Multiplatform Unique Visitors increases, we expect that we will generate additional revenue from our Managed Portals and Advertising solutions. We rely on comScore to provide this data. comScore estimates this data based on the U.S. portion of the internet activity of its worldwide panel of consumers and its proprietary data collection method.

Components of our Results of Operations

Cost of Revenue

Cost of revenue consists primarily of revenue sharing, content acquisition costs, co-location facility costs, royalty costs, and product support costs. Revenue sharing consists of amounts accrued and paid to customers for the internet traffic on Managed Portals we operate on our customers' behalf and where we are the primary obligor, resulting in the generation of search and digital advertising revenue. The revenue-sharing agreements with customers are primarily variable payments based on a percentage of the search and digital advertising revenue. Content-acquisition agreements may be based on a fixed payment schedule, on the number of subscribers per month, or a combination of both. Fixed-payment agreements are expensed on a straight-line basis over the term defined in the agreement. Agreements based on the number of subscribers are expensed on a monthly basis. Co-location facility costs consist of rent and operating costs for our data center facilities. Royalty costs consist of amounts due to other parties for license of email software with third party technology enabled. Product support costs consist of employee and operating costs directly related to our maintenance and professional services support.

Technology and Development

Technology and development expenses consist primarily of compensation-related expenses incurred for the research and development of, enhancements to, and maintenance and operation of our products, equipment and related infrastructure. Technology and development expenses also include certain costs of operating data centers domestically and internationally.

Sales and Marketing

Sales and marketing expenses consist primarily of compensation-related expenses to our direct sales and marketing personnel, as well as costs related to advertising, industry conferences, promotional materials and other sales and marketing programs. Advertising cost is expensed as incurred.

General and Administrative

General and administrative expenses consist primarily of compensation-related expenses for executive management, finance, accounting, human resources, professional fees and other administrative functions.

Depreciation and Amortization

Depreciation and amortization includes depreciation and amortization of our computer hardware and software, including our capitalized internally-developed software, furniture and fixtures, intangible assets, leasehold improvements and other property, as well as depreciation on capital leased assets.

Other Income

Other income consists primarily of foreign currency transaction gains and losses, and interest income earned.

Interest Expense

Interest expense consists of interest on capital leases and outstanding bank borrowings, if any.

Provision for Income Taxes

Income tax provision consists of federal and state income taxes in the United States and taxes in certain foreign jurisdictions, as well as any changes to deferred tax assets or liabilities, and deferred tax valuation allowances. Our income tax provision also includes amounts withheld for payment of income taxes upon payment of our invoices by our customers in certain foreign jurisdictions. Those amounts increase the amount of our foreign tax credit which would defray our U.S. tax liability if we were presently a U.S. taxpayer. However, because the deferred income tax assets relating to our federal tax attributes, including our foreign tax credits, are fully reserved, any such foreign tax withholdings are charged to our income tax provision. Such amounts paid may be carried forward to offset future federal income tax liabilities for a period of ten years. Finally, we record a deferred income tax provision to reflect the recognition of deferred tax liabilities relating to goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carry-forward periods.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

For a discussion of our critical accounting policies and estimates, see “Critical Accounting Policies and Estimates” included in our Annual Report on Form 10-K for the year ended December 31, 2017 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have updated our revenue recognition policies in conjunction with the adoption of ASC 606 as further described in Note 2 to the accompanying condensed consolidated financial statements. No other significant changes have occurred to our critical accounting policies and estimates.

Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed within this Quarterly Report on Form 10-Q adjusted EBITDA, a non-U.S. GAAP financial measure. We define adjusted EBITDA as net income (loss) plus: provision (benefit) for income taxes, interest expense, other (income) expense, gains on sale of investment, depreciation and amortization, asset impairments, stock-based compensation, acquisition costs and certain one-time items. We have provided a reconciliation below of adjusted EBITDA to net income (loss), the most directly comparable U.S. GAAP financial measure.

We have included adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short- and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization and asset impairments are non-cash charges, the assets being depreciated, amortized or impaired may have to be replaced in the future, and adjusted EBITDA does not reflect capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect the impact of tax payments that may represent a reduction in cash available to us;
- adjusted EBITDA does not reflect the impact of principal or interest payments required to service our capital leases or long-term debt borrowings (if any);
- adjusted EBITDA does not reflect the impact of the cost of business acquisitions on the cash available to us;
- adjusted EBITDA does not reflect the impact of non-recurring items, such as the costs associated with reductions in workforce, on the cash available to us: and
- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted EBITDA alongside other financial performance measures, including various cash flow metrics, net loss and our other U.S. GAAP results. The following table presents a reconciliation of adjusted EBITDA to net loss for each of the periods indicated:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Reconciliation of Adjusted EBITDA:		
Net loss	$(2,375)	$(6,656)
Provision for income taxes	20	446
Interest expense	97	87
Depreciation and amortization	2,435	2,184
Stock-based compensation	553	647
Other income	(119)	(6)
Adjusted EBITDA	$611	$(3,298)

Results of Operations

The following tables set forth our results of operations for the periods presented in amount and as a percentage of revenue for those periods. The period to period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Revenue	$32,915	$26,540
Costs and operating expenses:		
Cost of revenue [1]	15,217	12,562
Technology and development [1 2]	6,687	7,298
Sales and marketing [2]	5,936	6,661
General and administrative [1 2]	5,017	3,964

Depreciation and amortization	2,435	2,184
Total costs and operating expenses	35,292	32,669
Loss from operations	(2,377)	(6,129)
Other income	119	6
Interest expense	(97)	(87)
Loss before income taxes	(2,355)	(6,210)
Income tax provision	20	446
Net loss	$(2,375)	$(6,656)

Notes:

[1] Exclusive of depreciation and amortization shown separately

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2 Includes stock-based compensation, as follows:

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Technology and development	$134	$208
Sales and marketing	138	168
General and administrative	281	271
	$553	$647

	Three Months Ended March 31,	
	2018	2017
Revenue	100 %	100 %
Costs and operating expenses:		
Cost of revenue [1]	46	47
Technology and development [1]	20	28
Sales and marketing	18	25
General and administrative [1]	15	15
Depreciation and amortization	7	8
Total costs and operating expenses	107	123
Loss from operations	(7)	(23)
Other income	—	—
Interest income	—	—
Loss before income taxes	(7)	(23)
Provision for income taxes	—	2
Net loss	(7)%	(25)%

Note:

[1] Exclusive of depreciation and amortization shown separately

Comparison of the three months ended March 31, 2018 and 2017:

Revenue

	Three Months Ended March 31,		
	2018	2017	% Change
	(in thousands)		
Revenue:			
Search and digital advertising	$19,828	$13,545	46
Recurring and fee-based	13,087	12,995	1
Total revenue	$32,915	$26,540	24
Percentage of Revenue:			
Search and digital advertising	60 %	51 %	
Recurring and fee-based	40 %	49 %	
Total revenue	100 %	100 %	

Three months - 2018 compared to 2017. Revenue in the three months ended March 31, 2018 increased by $6.4 million, or 24%, compared to the same period in 2017. Search and digital advertising revenue increased by $6.3 million, or 46%. Search revenue increased by $2.2 million and digital advertising revenue increased by $4.1 million. The increase in search revenue was primarily due to revenue attributable to the AT&T Portal (including personal computers, smartphones and tablets) which was deployed during the second quarter, offset partially by the effects of ongoing migration of search activity at other portal customers from personal computers to other devices, such as tablets and smartphones, generally across the consumer base, and the residual effect of the placement of our Managed Portals and Advertising solutions on the second tab of the default Windows 8 and Windows 10 internet browsers. The increase in digital advertising revenue was driven in part by advertising revenue attributable to AT&T and in part by an increase in syndicated advertising revenue, partially offset by a decline in other portal advertising revenue.

Recurring and fee-based revenue in 2018 increased by $0.1 million, or 1%, compared to the same period in 2017 primarily due to increased Cloud ID licensing revenue and professional services revenue, offset by a decline in hosted email services and portal value added services.

Cost of Revenue

	Three Months Ended March 31,		
	2018	2017	% Change
	(in thousands)		
Cost of revenue	$15,217	$12,562	21
Percentage of revenue	46 %	47 %	

Three months - 2018 compared to 2017. Cost of revenue increased by $2.7 million, or 21% for the three months ended March 31, 2018 as compared to the same period in the prior year. The increase in cost was due primarily to the increase in revenue sharing costs (in particular with respect to AT&T) and increased syndicated advertising costs as a percentage of revenue.

Technology and Development Expenses

	Three Months Ended March 31,		
	2018	2017	% Change
	(in thousands)		
Technology and development expenses	$6,687	$7,298	(8)
Percentage of revenue	20 %	28 %	

Three months - 2018 compared to 2017. Technology and Development expenses decreased by $0.6 million, or 8%, in the three months ended March 31, 2018 as compared to 2017, as a result of lower compensation expenses in the quarter.

Sales and Marketing Expenses

	Three Months Ended March 31,		
	2018	2017	% Change
	(in thousands)		
Sales and marketing	$5,936	$6,661	(11)
Percentage of revenue	18 %	25 %	

Three months - 2018 compared to 2017. Sales and marketing expenses decreased by $0.7 million, or 11%, in the first quarter of 2018 as compared with same period in 2017. The decrease was primarily the result of lower expenses to support the AT&T portal services business, and lower related expenses necessary to support other sales and marketing initiatives across our product lines.

General and Administrative Expenses

	Three Months Ended March 31,		
	2018	2017	% Change
	(in thousands)		
General and administrative	$5,017	$3,964	27
Percentage of revenue	15 %	15 %	

Three months - 2018 compared to 2017. General and administrative expenses increased by $1.1 million, or 27%, in the three months ended March 31, 2018 as compared with the same period in 2017. The increase was due in part to increased legal expenses, audit and professional services costs, which was partially offset by an unrealized gain recorded on the stock of accesso Technology Group, plc.

Depreciation and Amortization Expense